RICHARD RUSSELL'S DOW THEORY LETTERS, INC.
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Sept. 24, DJIA 919.52; PTI 1297; A-D Ratio –23.96
Oct. 1, DJIA 907.74; PTI 1294; A-D Ratio –24.29

THE PICTURE: Although nothing has been proved (at least from a Dow Theory standpoint), the market spike that began August 13 has succeeded in turning most of Wall Street bullish. The same might be said of the economy–although nothing has been proved, a long list of economists are now predicting that "the low for business has been seen."

As I view it, this is a totally fascinating period. Think of it–the world is in semi-depression, unemployment is rising, nation after nation is in the throes of "re-scheduling" its debts, world competition for business is turning vicious. In the US commodities are continuing to slump, tool orders have collapsed, housing remains in the doldrums, auto sales are pathetic, retail sales are sluggish and consumer sentiment is apathetic to gloomy. Are we going into a world depression? Has Wall Street merely enjoyed a big pop preparatory to a resumption of the bear trend? Or does the August-September stock market explosion presage a coming attempt to reinflate and literally balloon us out of the dismal waters of deflation and semi-depression?

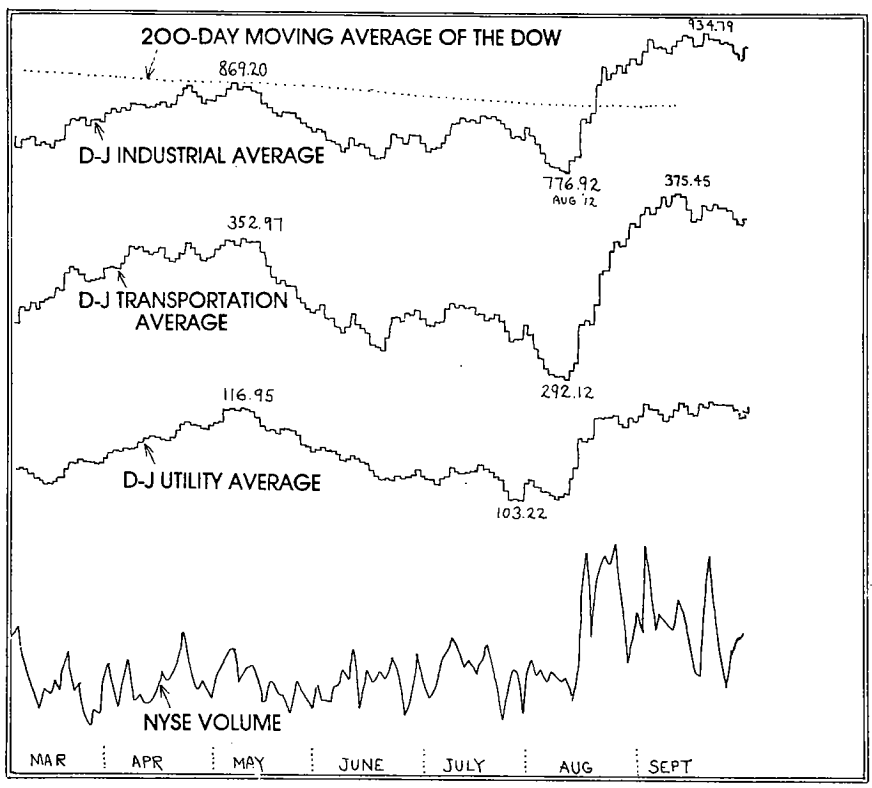
The secret, and here's the fascinating part of it, is contained in the action of the stock market. As I've written repeatedly over the past month, the Dow Theory states that *"the primary trend of the market continues in force until proved otherwise."* To translate, that means it's a bear market until proved otherwise. To date, there's been nothing to indicate that the tide has turned up.

The August 12 lows are (so far) the extreme bear market lows. But Dow Theory probabilities suggest that the August 12 lows will be broken in due time. If those lows are violated, if the primary bear market is fated to continue, then American business and world business will surely be heading into a major depression. And if the August 12 lows are broken, then stockholders will also find themselves subject to losses much worse than any they sustained during 1981-82.

FRONT PAGE COMMENT: The strength of the US dollar continues to amaze almost everyone. Last week the dollar surged in the face of a record monthly US trade deficit and in the face of lower US interest rates. Why is the dollar so strong? I've said this before: for 35 years the world has borrowed dollars in the expectation of paying off with inflated, worthless paper. This endless borrowing constitutes a massive short position against the dollar.

Now, with debts coming due and the world economy slumping, everyone needs dollars to stay alive. The dollar short position is exerting a gigantic squeeze on the borrowers. Everyone wants that once-hated piece of paper–the dollar.

But the strong dollar will bring the US *troubles* as well. US exports will slump (they are), US imports will expand (they are, since foreign goods are cheap in terms of dollars). And profits of large US corporations will suffer, since many top US companies garner a large percentage of their profits from foreign sales.



As I have said, the secret is contained in the Averages. But let's say, for the sake of argument, that the bear market did end on August 12. All right, then we are looking at a 158 point Dow rally to the September 21 Dow high of 934.79. From there we should have a "normal" 1/3 to 2/3 correction of the rise. Such a correction could take the Dow back to the 880-830 area; it could also take the Transports back to the 350-320 zone.

If, after that kind of full correction, the two Averages then turn up and better their September highs of 934.79 and 375.45 respectively, the Dow Theory will have signalled a turn in the tide–a turn in the primary trend from bear to bull.

On the other hand, if the Averages correct fully on the downside, and then continue to decline, eventually breaking their August lows, at that point we'll know that the bear was simply having fun with investors–and that the primary trend continues relentlessly down.

In the meantime, the Averages are fluctuating in what I term "no man's land." This is the area beneath the recent (September) highs, but above the August lows. It is an area in which no man can, *with certainty*, know the true direction of the primary trend.

Question: Russell, let's say that a new bull market did begin on August 12. If so, where would you buy stocks?

Answer: The safest place to buy stocks would be at the end of the first correction. Say a correction has already started from the September highs. The market will head down. The point where the decline seems to be running out of steam would be the place to buy. If the market wanted to give us perfection in a buy spot, then we would get a downside non-confirmation such as an Industrial plunge below the August 12 low of 776.92 (amid great panic and fear) with the Transportation Average refusing to confirm (Transports would have to hold above their own August low of 292.12).

Question: What do you think of the chances of a full correction of the August-September rise?

Answer: Every market movement, whether primary, secondary or minor,is subject to approximately a one-third to two-thirds correction. The rise from the August 12 low will be no exception.

Question: Russell, you keep repeating that "the trend is taken to remain in force until proved otherwise". This seems an awfully simplistic approach. Is it really valid?

Answer: Yes, it is valid. But it must be remembered that the older the bear (or bull) market, the more careful you must be with this concept. Ultimately, there will be a final decline which will prove to be the LAST decline in the market. At that point, the "trend continues" thesis will finally be incorrect. Like everything else, a little gray matter must be mixed in with your market rules. However, I do think that the "trend continues" concept is valid at this time in this bear market.

Question: Russell, I know that nothing has been proved one way or the other regarding the primary trend. But in view of the Dow Theory concept that the bear market continues until proved otherwise, how do you account for the fact that so many leading market analysts have now turned bullish?

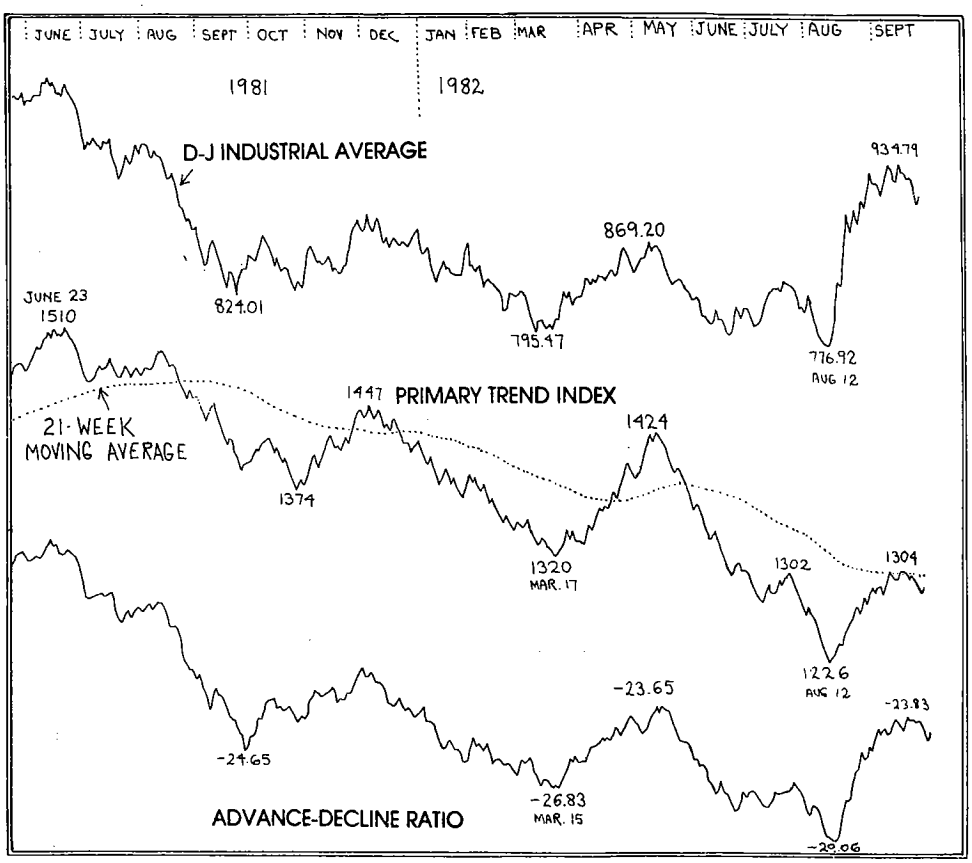
Answer: Anyone is entitled to draw inferences and make educated guesses regarding the trend. But preservation of capital (which I advocate above all) dictates that we take major action only after bona fide Dow Theory signals. Thus, those buying during the August-September rally were gambling on the hope that the primary trend of the market had indeed turned bullish.

Maybe they're correct, but I feel that many newer analysts are operating under extreme pressure. They want to make a name for themselves. They want to light up the skies. They want to see their name in the Wall Street Journal and the New York Times. But above all, they want to expand their businesses. So the wish may prove father to the "pronouncement." Many analysts proclaim "a new bull market," they are quoted by the press, they are interviewed on prominent TV shows.

I prefer to be conservative. I prefer to treat my subscribers' money the way I treat my own money. I prefer to wait for solid evidence regarding the trend. If we are in a new bull market, we have a long way to go on the upside. If the August-September burst was simply a big rally in an ongoing bear market, then there will shortly be a lot of red faces and thin wallets on Wall Street and Main Street.

Question: What else are you watching here besides the Averages?

Answer: As usual, I'm watching a wide spectrum of indicators. I write about the Averages *first*, because they are the simplest and in many ways the most reliable indicators to follow.



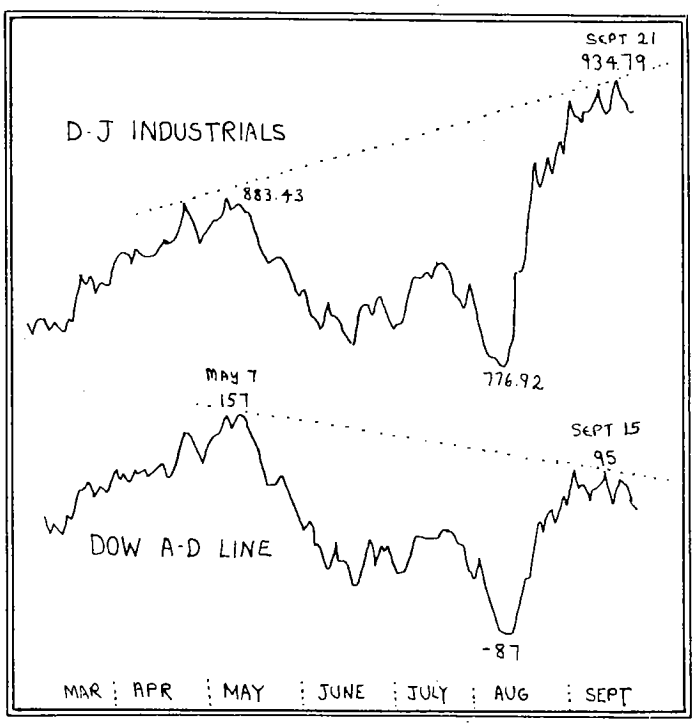
For instance, one of the items I'm watching is the A-D line for the 30 D-J Industrial issues. On May 7 with the Dow at 883.43 the Dow A-D was at 157. During August both the Dow and its A-D line sank to new bear market lows. (chart pg. 3)

Then came the upside explosion which took the Dow to a September 21 high of 934.79. But note that the Dow A-D halted at a value of 95 on September 16. Thus, the Dow A-D failed by a wide margin to confirm the recovery high in the Dow. By September 28 the Dow A-D was beginning to break down. The divergence which existed since the May 7 highs was beginning to put a strain on the Dow.

Turning to the Primary Trend Index (PTI), it is interesting to note that the March-May rise took the PTI from 1320 to 1424, an advance of 104 points. The August-September rise has advanced the PTI from 1226 to 1304, a gain of only 78 points. Yet the Dow during August-September gained better than twice as many points as it did during March to May.

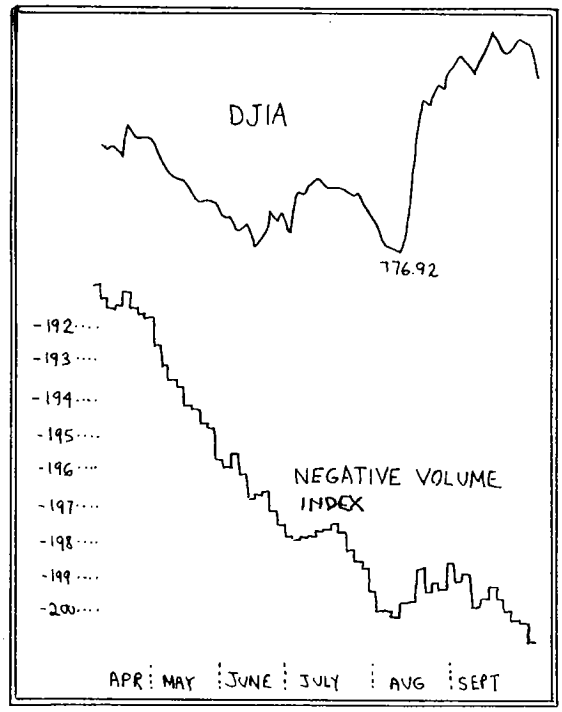
The PTI has pushed up to the area of its 21-week moving average, and for the past two weeks the PTI has been "walking the line." The action of the PTI is extremely important here, and I urge subscribers to study the 16-month profile of the PTI as seen on the accompanying chart. The action of the PTI, considering the spike-explosion in the Dow, has been unimpressive. The story may not be in yet, but if you mask out the Dow and look at the PTI alone, it is surprising that so much bullish excitement could be set off by only a 78 point rise in the PTI.

The A-D ratio (a proxy for the entire NYSE) has advanced a total of 5.23 points since August 12. Since the A-D has advanced over 5 points without so much as a one point correction, the rise qualifies as a "buying stampede." Strangely, the A-D has (so far) failed to better its May 7 peak of minus 23.38. This constitutes a major non-confirmation, and time will tell whether this technical abnormality will cause trouble for the market.

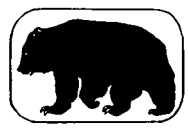


The negative volume index (which monitors breadth on days when NYSE volume is lower than the preceding day) has now fallen to a new bear market low. What does this mean? I have always accepted the negative volume index as an indicator of the *direction of informed money.* My only conclusion therefore is that the rally since August 12 does not have the support of informed money. What this means (unless something new is happening) is that since August 12 stock shares have moved from informed to uninformed hands.

Conclusion: From a Dow Theory standpoint, the primary trend continues down. On September 30 the Dow (having formed a toppy looking structure) closed at 896.25. This was the lowest Dow closing since August 30. Since August 30, approximately 1.6 billion shares have changed hands–mostly at higher prices. The 875 level appears to be an important support-resistance level on the Dow. A break below 875 could trigger a bearish lock-in and set off major selling pressure in the market.



INVESTMENT POSITION: I continue to stress capital preservation during this period. Remember this–time always works in favor of the primary trend. During a bear market, values deteriorate through time. Thus, even during major rallies in a bear market the underlying business conditions continue to deteriorate. This is what makes the ultimate breakup of a bear rally so vicious and costly.



Safe, perspiration proof positions here are roughly 75% of one's assets in 3-month or 6-month T-bills, and 25% in 5-10 year T-notes. We're not trying to beat this bear, we're trying to survive him.

GATHERING STORM: I've been warning for almost three years that the US must "inflate or die." I'm going to revise that statement. My new thesis is that "The *world* must inflate or die." Why, why so cynical, Russell? And the answer is the debts, and more specifically the debts coming due. You can't build up massive debts and then pay them off with expensive dollars in a world economy that is SHRINKING. It's just too hard to raise funds in a world where business is sliding and liquidity is becoming a problem.

Let's take a quick look at a few of the things that are happening. Mexico has been temporarily bailed out by US loans, so now it can pay some of the interest on its $60 billion in debt. But rumors are flying to the effect that Argentina might repudiate its $39 billion of debt, and bankers are questioning the debt of Brazil, Venezuela, Chile and Cuba.

Meanwhile, Jacque de Larosiere, managing director of the IMF, forecasts no real growth for the industrial countries this year. He also pointed out that the growth of the non-oil developing nations in 1981 and '82 was the lowest in several decades (helping to explain why they can't pay the interest on their debts). As for the oil producing nations, their petro-dollar surplus boomed to $116 billion in 1980. But this year that surplus has plunged to $15 billion due to the oil glut. Worse, the non-oil developing nations increased their medium and long-term debt over the three years to 1981 by about 60% to an unbelievable

$440 billion, and about three-fifths of this debt is owed to private financial institutions.

All of which explains why bankers are biting their nails and why gold has risen. Stocks have risen for the same reason. The only difference is that gold doesn't need to earn money to stay up–but stocks do.

Question: Russell, OK, so there's a lot of debt out there, and a gob of it is coming due during the next 12 months. So what happens now?

Answer: Well, a majority of the debt coming due is owed to private financial institutions. And that means that we would be heading into an all-out banking crisis (world-wide) unless MORE CREDIT is extended to the debtor countries. So that's what I see ahead. The IMF will have to lend more money, the Fed will have to arrange loans, the banking system will have to be held up–or should I say that the various governments will attempt to hold their banking systems up.

At any rate, there will be a certain amount of debt that will be reneged on, and that debt will go down the drain. And a lot of debt will be rescheduled, which is another way of saying moratorium and hopefully payment later.

Question: Why the devil did the banks make all these bad loans?

Answer: The bankers are greedy, and they are competitive. Like the funds, the banks figured, "We've got to get in on the action, we've got to make profitable foreign loans like the rest of the guys. Even if we never get our principal back, the interest payments will be so generous that it doesn't matter. And if the loans go bad, then all the other guys will be in the same boat we are, so we'll plead innocence (you see, these loans were made by huge consortiums made up of dozens of banks, and they were all going to get rich together). And remember, just as the funds purchase stocks with other people's money, the bankers made loans with other people's money.

Question: What does all this have to do with gold and stocks?

Answer: Everything! If I'm guessing correctly, a huge amount of new credit will have to be created to carry these insolvent loans. There's also going to be a good deal of uncertainty about whether the various debtor nations are going to make it, even with rescheduled loans. A vast amount of money is pouring out of the insolvent countries. That money wants to (1) stay safe, (2) stay liquid. What are the most liquid investments in the world? The first is gold, the second is US blue chip equities. The third is US government paper. And that's where a huge amount of foreign money has gone.

Question: But aren't these actually chancy investments, Russell?

Answer: Every investment has its risks. Gold can fluctuate in terms of paper currency required to purchase it, but gold is always there. Gold is money that is not managed, it does not have to make a profit. There is no risk that gold will disappear and that is why it needs to pay no interest (of course, gold can be confiscated, but so can any other property).

Stocks like General Electric and Merck will be there. They may not earn a profit, they may go down50% in value, but they are liquid and they are as permanent as a corporate entity can be. So foreign money is moving into stocks. But I repeat, there is only one fundamental reason for a bull market, and that is a *rising trend in corporate earnings*. Buying stocks for safety in the face of a world slowdown is a risky procedure, and in the end it will produce losses.

US government paper is the world's safest. The US is the strongest nation in the free world, and the dollar is the reserve currency. Investors are buying T-bills and notes and bonds on the basis of safety of principle. You can get higher rates in a thousand other places, but investment money opts for safety first, liquidity second, return last. Investment money wants T-bills, and it is willing to wait for higher yields later.

WORLD PROBLEMS: *Question:* Russell, which countries are now the weakest?

Answer: Euromoney magazine published a study using six criteria, in which over 80 nations were graded. The bottom of the list as far as economic strength showed the following: Iran, Peru, Turkey, Brazil, Uganda, Chile, Israel, Zaire, Ghana, and last Argentina. Tops in performance during the 1974-82 period were Saudi Arabia, Singapore, Hong Kong, Taiwan, Malaysia.

Question: What would happen to the dollar if the world banking system collapsed?

Answer: No one, obviously, can know for certain, but I would say that the Fed would issue massive credits to US banks in an effort to keep them solvent. It is the spector of these massive credits that has moved gold higher (on the thesis that such credits would be inflationary). As far as the dollar is concerned, I continue to believe it is the strongest of the leading world currencies. The buying power of the dollar should continue strong.

Question: All right, suppose the Fed were to issue billions in credit to the banks. Would this be inflationary?

Answer: Personally, I don't think it would. Remember, if the Fed had to issue these credits it would be under panic conditions, and under such conditions we would see many institutions teetering on the edge of bankruptcy. The business situation would be deflationary, with many people selling their products just to raise cash (liquidity). Under those conditions, I do not see loans or guarantees to the banks as being inflationary. It could well be that the destruction of capital via bankkruptcy would surpass any new credits that would be issued by the Fed.

Question: Russell, what could set off a world collapse?

Answer: Waning confidence–the fact is that the world is held together now, not by liquidity or true solvency, it is held together by confidence that it will continue to be held together. If something happens to shake this confidence, then we could see a run to cash or gold or dollars or tangibles. If the public's confidence is shaken by some unforeseen event, and if that event set off a world panic, then the resultant liquidation would be beyond the power of governments' control. In that case, we could see a "calling of the cards" and an accompanying panic. Remember, by definition a panic is a situation that runs out of control.

To my mind, in view of the amount of bad loans held by US and foreign banks, the situation resembles a game of poker. You may

hold a poor hand, but as long as nobody calls you–you look OK. You may even bluff your way through and win. But if the cards are called you will be forced to pay up. At that point, your confidence collapses, the ploy is over, and you lose.

Question: Russell, with billions of dollars in "non-performing loans" (a euphemism for bad debts) on the part of the banks, how is it that no one is called on the carpet? After all, banks are supposed to be the guardians of their depositors money. Yet I don't read about any indictments, I don't even read about any hand-slapping, nothing. How can this be in the face of billions in bank losses?

Answer: In the first place, most of the major loans were approved by a bank board. Many of the board members are now retired. If the original loan approvers were indicted, they would simply say, "Those loans looked fine when my bank made them. Years later they did not look so good, but I wasn't there." Or they might say, "The loans looked great when I approved them, but supervision of the loans was made later by other men. It was out of my hands."

But beyond this, it must be remembered that bankers are brothers-in-arms. And many of the men who might blow the whistle are also bankers or former bankers. So the unwritten answer is, "Look, any banker can make a mistake. Any banker can make a good loan that later goes bad." So billions of dollars in bad loans pile up with no one taking the blame. Oh yes, the public will pay–via bailouts by the Fed. Whose dollars, whose credit is it that the Fed extends? Your's and mine. The Government can only give away what they take from us–through either taxes or inflation.

NOTES & QUOTES: Paula and I are back in La Jolla, after a most pleasurable visit to my old home town, New York. On arriving in the City, we experienced the usual excitement (does everybody go through this?) Last time we visited NY, we no sooner left the hotel when we witnessed a robbery. This time I arrived one day ahead of Paula. When Paula came in she told me that the elevator was "boiling with policemen." "What's going on?" I asked. "A woman's been murdered upstairs." It turned out that the Waldorf had suffered the first murder in its long history (a Chase Manhattan executive had been stabbed to death a floor above us). So much for our arrival.

The Conference was fine. I was interested to note that the great majority of speakers were bullish on the stock market and optimistic about the economy. I left the city with two unshakable convictions: (1) the Four Seasons restaurant serves the best desserts in America. (2) Lello's restaurant serves the greatest pasta in North America.

I also offer two observations: (1) every block in NYC has a chocolatier, a baker or a deli. To stay thin in NYC is impossible. (2) The Japanese are obviously crazy about NY. Walking through the Waldorf lobby, I thought I was in Tokyo.

* *

Can the market go up in the face of declining corporate profits? Yes, if it's a bull market and it is discounting a turn to higher profits in the period ahead. Is that what today's market is doing? We don't know, because this is not a confirmed bull market. But we do know one thing–corporate profits are slumping over the foreseeable future. This little clip tells the story, at least as Standard & Poor's see it.

By Reuters

The 1981 profit margins of the 400 companies that make up its industrial stock price index were the second-lowest in 30 years and promised to be worse this year, the Standard & Poor's Corporation said yesterday.

It said profits as a percentage of sales averaged 4.86 percent in 1981, the second successive year that American industry made less than 5 cents on each dollar of sales.

It said the return was the lowest in the past six years and the second-worst since 1951, the first year covered by the company's annual study.

Standard and Poor's said the 400 industrials averaged a 4.06 percent return in first half 1982, and any improvement in the second half would be slight.

Its chief economist, David Blitzer, said, "We are projecting a 20 percent year-to-year drop in corporate after-tax profits in 1982. That drop will be reflected in a continuing contraction of corporate profit margins."

Mr. Blitzer, who blamed the disappointing profit margins on the recession and high interest rates, said "any substantive improvement in those margins is not likely to take place until 1983."

Here's the latest on what our government laughingly calls its finances. Note that interest on the national debt for 11 months is $108 billion, so we're looking at near $120 billion for the full fiscal year. That means that 16% of all government spending now goes towards carrying the debt (a decade ago it was around 10%). This is the compounding effect. Within a few years, the government will be spending $1 out of every $5 to carry its debt burden. It's an interesting process. The process is called "eating yourself alive." Ultimately this process will run interest rates through the roof–or cause a moratorium on debt, or both.

Government Finances

WASHINGTON (AP) – Here are figures on government spending and debt (last six digits are omitted). The government's fiscal year runs from Oct. 1 through Sept. 30.

Total pblc dbt Spt 24	1,111,236
Interest on public dbt Ag	9,476
Interest fscl yr thr Ag	108,344
Projectd dfct fscl 1982	108,884
Projectd dfct fscl 1983	115,018
Actual deficit fiscl 1981	57,932
Recepts fscl yr thr Ag	558,072
Receipts period lst yr	538,993
Outlays fiscl yr thr Ag	667,021
Outlays period last yr	603,260
Gold for July	11,149

AH' PERFECTION: Twice before I've written on this subject, and I still get many requests for it every week or so. The question: What is the perfect business for men to get into? There will never be a perfect business, but there are a number of

factors that go toward identifying a very good business. Here are some of them, as I see it. The perfect business should have the following attributes:

(1) The perfect business is relatively free of government regulations.
(2) The perfect business does not tie up large amounts of capital.
(3) The business requires enough specialized knowledge or equipment so that it is very difficult for the average outsider to enter.
(4) The business deals with a product or an approach that cannot be copied. Nor will the product or approach be rendered obsolete in a year or so.
(5) The perfect business is not employee-intensive. In other words, it does not have a big overhead in personnel.
(6) The business produces a product that is inelastic in price. In other words, the business sells a product which people want almost regardless of price.
(7) The perfect business has a world market, it's sales are not confined to a local area (this means that it's sales potential is unlimited).
(8) The perfect business does not require huge expenses to generate sales, such as high advertising or high direct mail expenses (both advertising and direct mail are very costly, these days, and getting worse).
(9) The business has unique tax advantages, such as high depreciation or deferred income.
(10) The business does not have a high profile. Raging successes invite intense competition.

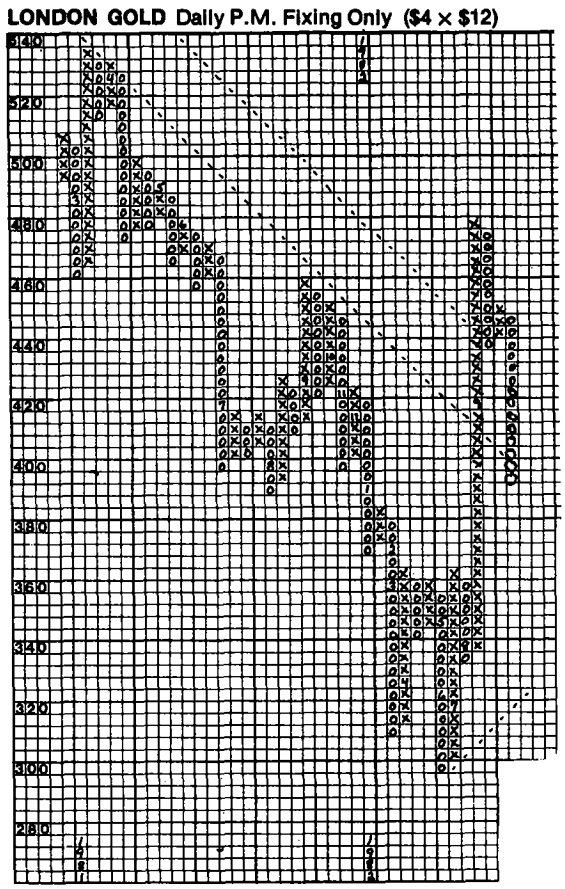
GOLD: Sometimes you get the feeling that all is not right. I just asked my printer downstairs about Neynisch Printers, for years one of San Diego's largest printers. "They went broke a few months ago," he told me. I was shocked.

One of the largest gold and coin dealers in the West has been North American Coin. I just received this letter from a subscriber: "Tale of woe time. However, the following experience may benefit other subscribers. I bought Krugerrand from North American Coin & Currency here in Phoenix. I ordered by phone and sent them a check. I always take delivery of the coins, but they won't release them until a check clears.

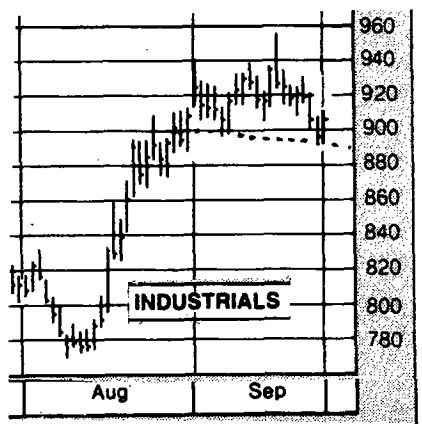
"As luck would have it, my check cleared this past Monday, the day they closed the doors without explanation. Yesterday they filed Chapter 11 bankruptcy. I will file a claim with the US bankruptcy court, but at this point I'm taking an attitude that all is lost. Hopefully, there's a safer way to transact a deal. I could have paid in cash but didn't because of convenience and safety reasons." (KW, Phoenix).

Russell advice: buy gold coins with a certified check and walk away with the coins. Don't let someone else "hold them for you." When you buy gold you're shooting to be as safe as possible. That means having the gold in your possession–immediately!

Gold has corrected back, following its explosive move from 297 to over 500. The point & figure chart (courtesy of Chartcraft, Larchmont, NY) shows a trading sell signal at 436 and a plunge down to the 396 level. This is a normal (violent) correction following a violent advance. The drop was scary enough to shake out a lot of gold holders, but technically it was not negative. At this week's average price of 403, gold was 30% above its price of 13 weeks ago. The 5-week moving average now stands at 421, well above the 13-week MA which is 396. The 50-week or primary MA is at a new high of 385. It will be very important for the average weekly price for gold to hold above the 385 level. Gold remains in a bull trend.



LATE NOTES: A market top is only identified with certainty AFTER the event. But this daily chart of the Dow does present the profile of a potential top. A rally from last week's 890 (Dow) area would appear to add a right shoulder to the pattern on the chart. A break below 875 on the Dow would complete the top structure.



Volume on the rise above 875 has been huge with over 2 billion shares changing hands.

NEXT MAILING: October 20